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No. 92-1751

In The

Supreme Court of the United States

October Term, 1992

ALCAN ALUMINUM CORPORATION,

Petitioner,

v.

FRANCHISE TAX BOARD
OF THE STATE OF CALIFORNIA,

Respondent.

**On Petition For A Writ Of Certiorari
To The Court Of Appeal Of The State Of California
In And For The Second Appellate District**

BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the California Courts properly declined to apply a dormant Commerce Clause analysis and properly held that, due to congressional acquiescence, California did not violate the Foreign Commerce Clause by application of worldwide combined reporting to determine the taxable California income of petitioner.

2. Whether the petitioner's trial stipulation, limiting the issues in this case to those involving "one voice" and "multiple taxation" contentions, has limited this Court's jurisdiction, with the result that petitioner is barred from raising questions concerning the four elements of the dormant Commerce Clause analysis set forth in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1974), including whether the tax assessed against petitioner was out of all proportion to its business in California.

3. If a dormant Commerce Clause analysis were appropriate, would California's use of worldwide combined reporting violate the "multiple taxation" test or the dormant portion of the "one voice" test?

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JURISDICTION

Petitioner Alcan Aluminum Corporation ("Alcancorp") invokes jurisdiction under 28 U.S.C. § 1257(a). As argued below at pages 12-16, no such jurisdiction exists as to issues beyond the limited issues designated in the portion of the trial stipulation which is reproduced herein in Appendix A at App. 1.

STATUTORY AND CONSTITUTIONAL PROVISIONS

Appendix B hereto is California Revenue and Taxation Code section 25110, regarding California's "water's edge" election.

SUPPLEMENTAL STATEMENT OF THE CASE

This case involves precisely the same primary issue as was presented to this Court in the petition in *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384. Both *Barclays* and *Alcan* involve California's application of worldwide combined reporting ("WWCR") to determine the California taxable income of corporations which are parts of multinational, multicorporate unitary businesses headed by foreign corporations. As long as the California Supreme Court has properly held (in *Barclay's Bank Internat., Ltd. v. Franchise Tax Bd.*, 2 Cal.4th 708, 829 P.2d 279 (1992)) that the United States Congress has acquiesced in such use of WWCR by the states, there is no need to grant the petition for certiorari in either *Barclays* or *Alcan*. On May 17, 1993, this Court requested the views of the Executive Branch as to the *Barclays* petition.

Respondent Board believes that Alcancorp's statement of the case contains significant omissions which, among other things, go to the issue of whether this Court has jurisdiction over issues which petitioner seeks to have reviewed. Therefore, pursuant to rule 15.1, the Franchise Tax Board provides this Court with this supplemental statement.

Petitioner Alcancorp does not comply with this Court's rule 14(h), which requires a showing in the statement of the case "that the federal question was timely and properly raised so as to give this Court jurisdiction to review the judgment on a writ of certiorari." The reason for this noncompliance is simple: Alcancorp did not properly raise the federal questions involving the dormant Commerce Clause requirements set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

Prior to the commencement of trial in this matter the parties entered into the following stipulation with respect to the issues in this case:

"*ISSUES*

> "For the purposes of this litigation, these parties hereby stipulate that the *only* legal issues before this Court are whether the Board's application of the unitary method of accounting under Section 25101 *et. seq.* of the California Revenue and Taxation Code, and implementing regulations, as applied to the facts in this case violated the Foreign Commerce Clause of the United States Constitution in that such application impermissibly prevents the federal government from speaking with *one voice* or impermissibly gives rise to either the risk of or actual *multiple taxation*. For purposes of this litigation, Alcan is not contesting the Board's determination that the Alcan Group Companies constitute a single unitary business under the tests formulated by the California Courts and the United States Supreme Court, or contending that the tax assessed violated the Due Process Clauses of the United States Constitution or the

California Constitution." Appendix A hereto at App. 1 (CT 0062) (emphasis added).

The appellate court decision below found that Alcancorp had waived by stipulation the consideration of any Due Process Clause grounds and specifically the claim that "compliance would impose an undue administrative burden on [Alcan] Aluminum." Pet. App. A-3, n. 2. Neither the trial court, the appellate court nor the California Supreme Court found it necessary to rule upon the effect of the stipulation as to any dormant Commerce Clause issues in this case, because the California courts' application of this Court's decision in *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986), precluded the need for any dormant Commerce Clause analysis.

This Court need not accept Alcancorp's invitation (Pet. 19-21, 23-24) to delve into the complex facts concerning Alcancorp's Riverside facility, for (1) Alcancorp first says it does not need to rely upon separate accounting to establish alleged distortion under worldwide combined reporting, then proceeds to do so; (2) Alcancorp (at Pet. 17-18, 22-23) is asking this Court to discard "present doctrine," that is, to overrule more than 70 years of precedents, including *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983); (3) Alcancorp's stipulation in the trial court limited the legal issues so as to exclude the distortion issue, thus relieving respondent Board from any burden of presenting any evidence concerning the Riverside facility in order to establish the lack of distortion; and (4) as established below at pages 6-11, Congress' exercise of its Commerce Clause powers in acquiescing in the states' use of worldwide combined reporting has rendered unnecessary any consideration (as

part of a dormant Commerce Clause analysis) of the facts concerning the Riverside facility.

Beyond the stipulated limitation of issues, Alcancorp also has stipulated (App. A hereto at App. 1-2, ¶ 23) that petitioner Alcancorp did not elect to petition the Board for relief under the authority of California Revenue and Taxation Code section 25137, cited by petitioner (Pet. 3-4) as a statutory provision involved in this case.

This Court should also be aware of the actions of Canada in this area. Canada and the United States concluded renegotiations of their bilateral income tax treaty in 1980. Although a letter indicated the Canadians' displeasure with the states' use of worldwide combined reporting ("WWCR"), the renegotiated treaty had no provision restricting such use, because (as recognized by the Canadians) the United States Senate had recently rejected such a proposed limitation. This situation was acknowledged in a note from G. William Miller, Secretary of the Treasury of the United States, to Allan I. MacEachen, Minister of Finance of Canada, and it was agreed that discussions would be reopened on this issue if an acceptable solution were found. Exhibit XXVI-1, attached hereto as Appendix C.

Canada and the United States are members of the Organization for Economic Cooperation and Development (OECD). This organization has drafted a Model Tax Convention for use by its members, wherein arm's length/separate accounting requirements would be applied to both national and subnational taxes. Exhibit XXIII, pp. 24, 28-29. Both Canada and the United States noted exceptions to the Model Treaty clause which would

make the treaty applicable to subnational taxes. Exhibit XXIII, p. 50.

ARGUMENT

I

THE CALIFORNIA COURTS HAVE PROPERLY APPLIED THIS COURT'S *WARDAIR* DECISION IN HOLDING THAT CONGRESSIONAL ACQUIESCENCE IN CALIFORNIA'S USE OF WORLDWIDE COMBINED REPORTING IS DETERMINATIVE OF THE COMMERCE CLAUSE ISSUE, WITH NO NEED FOR ANY DORMANT COMMERCE CLAUSE ANALYSIS.

Alcan's contentions regarding *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986), are based upon a direct misrepresentation of this Court's *Wardair* holding. Alcan's petition contains the following remarkable contention: "In *Wardair*, this Court did not conclude that a dormant Commerce Clause analysis was not appropriate because Congress had acted to permit the tax. Rather, this Court concluded that the case was not appropriate for a dormant Commerce Clause analysis because both of the parties agreed that none of the elements for such an analysis existed. . . . " Pet. 25. This contention finds no basis in the *Wardair* record or opinion.

Directly contrary to petitioner's contention, in *Wardair* this Court rejected dormant Commerce Clause "one voice" arguments on the basis that "in the context of this case we do not confront federal governmental silence of the sort that triggers dormant Commerce Clause analysis.

On the contrary, . . . the Federal Government has affirmatively acted, rather than remained silent, with respect to the power of the States to tax [in the challenged manner], and thus . . . the case does not call for dormant Commerce Clause analysis at all." 477 U.S. at 9. "[T]he *law* as it presently stands acquiesces in taxation . . . by political subdivisions of countries." *Id.* at 10 (emphasis in original). "By negative implication . . . the United States has at least acquiesced in state taxation. . . . " *Id.* at 12. "In our view, the facts presented by this case show that *the Federal Government has affirmatively decided to permit the States to impose these . . . taxes.* . . . " *Id.* at 12 (emphasis added).

In *Barclay's Bank Internat., Ltd. v. Franchise Tax Bd.*, 2 Cal.4th 708, 829 P.2d 279 (1992), the California Supreme Court correctly applied *Wardair* in a manner fully consistent with this Court's February 1993 holding in *Itel Containers International Corp. v. Huddleston*, ___ U.S. ___, 113 S.Ct. 1095, 1105 (1993), the most recent Foreign Commerce Clause tax case. In *Alcan* the California Court of Appeal has followed the California Supreme Court's application of *Wardair* in holding that no dormant Commerce Clause analysis is applicable in this case. Pet. App. A5-A7. The California Supreme Court has denied review. Pet. App. A9. As the Board has argued in opposition to the *Barclays* petition, there is no need for this Court to exercise its jurisdiction to revisit this constitutional area at this time. The California courts have properly applied *Wardair;* both the *Barclays* and the *Alcan* petitions should be denied.

The California Supreme Court's Commerce Clause holding in *Barclay's* applies *Wardair* to conclude that Congress has acted to acquiesce in the state tax practice

which both Barclays and Alcan are challenging. That being so, the California Supreme Court pointedly did not engage in any dormant Commerce Clause analysis. 2 Cal.4th at 742; 829 P.2d at 300. This approach is consistent with this Court's warning in *Wardair*: "It would turn dormant Commerce Clause analysis entirely upside down to apply it when the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow." 477 U.S. at 12 (emphasis by this Court).[1]

In holding that the *Wardair* rule was applicable to permit California's use of worldwide combined reporting ("WWCR") in the present case, the California Supreme Court placed its primary reliance on the United States/United Kingdom ("US/UK") Treaty which was negotiated and ratified in the 1970's. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasions with Respect to Taxes on Income and Capital Gains, Dec. 31, 1975, U.S.-U.K., 31 U.S.T. 5668 (Exh. XXV-33). For the first and only time, the federal Executive Branch negotiated a provision for that treaty, article 9(4), which would have explicitly prohibited any state's use of worldwide combined reporting ("WWCR").

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[1] Since the Commerce Clause (U.S. Const. art. I, § 8(3)) gives the power to regulate foreign and interstate commerce to Congress, "any action taken by a State within the scope of the congressional authorization is rendered invulnerable to Commerce Clause challenge." *Western & Southern L.I. Co. v. Bd. of Equalization*, 451 U.S. 648, 653 (1981); see also *Wardair*, 477 U.S. at 12-13.

After much debate, and several votes in the Senate, the treaty was ratified only after that provision was rendered totally inapplicable to the states. 124 Cong. Rec. 18416 (June 22, 1978; Exh. XXIX-3), 19076 (June 27, 1978; Exh. XXIX-6). After more bargaining with the United Kingdom, wherein the United Kingdom exacted other federal tax concessions from the United States, the United Kingdom accepted the treaty with the prohibition of WWCR applicable only to the national governments, not to the states. 31 U.S.T. 5709, 5713. Thus the states' use of WWCR was directly considered as a tax issue during the formulation of the treaty, but the *states'* use of WWCR ultimately was not restricted in the final adoption of the treaty as a part of United States law.

The US/UK Treaty provides a perfect context for the application of the *Wardair* rule: a clear congressional consideration of whether a state tax practice (WWCR) should be permitted, and a final ratification of a treaty which by clear implication permitted the states' application of that tax practice (WWCR). At the time of the final Senate vote, the clear and acknowledged choice before the Senate was either to ratify the US/UK treaty while permitting the states to use WWCR or (since ratification with original article 9(4) had proved impossible) not to ratify the treaty. See 124 Cong. Rec. 18709-12 (June 23, 1978) (statements of Senators Byrd, Church, Javits, Stevens, Sparkman, Cranston and Packwood; Exh. XXIX-4). By more than the required two-thirds vote (82 yeas, 5 nays), the Senate chose to ratify the treaty while permitting (by implication) state use of WWCR. 124 Cong. Rec. 19076 (June 27, 1978; Exh. XXIX-6). In the words of the *Wardair* decision, the Senate has "at least acquiesced" in the use of WWCR

by the states, and under the *Wardair* holding such acquiescence is fully sufficient to establish that the federal government has "affirmatively decided to permit" state use of WWCR. 477 U.S. at 12-13.[2]

The California Supreme Court correctly analogized its holding on the present issue to *Wardair*:

> "The parallels between this evidence of 'governmental silence' or refusal to act and that regarded as decisive in *Wardair, supra,* 477 U.S. 1, seems to us both evident and compelling. As in *Wardair,* an international agreement (here the bilateral income tax treaty between the United States and the United Kingdom) demonstrates that while federal executive branch officials *aspired* to eliminate a state tax practice (here the use of formula apportionment to calculate the tax liability of foreign-based multinationals), 'the *law* as it presently stands acquiesces' in the states' continued use of that practice. As in *Wardair,* the 'negative implications' of international agreements (here the tax treaty as ratified by the Senate) support recognition of a federal policy that *acquiesces* in the states' tax practice. And

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[2] It is significant in the present case that, in negotiating the current U.S./Canada Income Tax Treaty (which also has no restriction upon the states' use of WWCR), the government of Canada recognized that the Senate had rejected proposed treaty limitations of the states' use of WWCR. Exh. XXVI-1, attached hereto as Appendix C. As this Court stated in *Wardair,* referring to another U.S.-Canadian agreement, "in the U.S.-Canadian Agreement only 'national' charges are barred, and we presume that drafters from two federalist nations understood this as representing a choice not to preclude local taxation." 477 U.S. at 12.

> certainly, in the circumstances of Senate consideration detailed above, the explicit removal of 'political subdivisions' from the scope of article 9(4) effected by the Church reservation, like the omission of restrictions on taxation by political subdivisions in the international agreements considered in *Wardair*, 'must be understood as representing a policy choice by the contracting parties.' (*Wardair, supra*, 477 U.S. at p. 11." *Barclay's Bank*, 2 Cal.4th at 735, 829 P.2d at 295-96 (emphasis in original; footnote omitted).

Recognizing that formula apportionment such as WWCR has been a matter of international interest from at least the mid-1950's (2 Cal.4th at 737-38, 829 P.2d at 297-98), and noting that indications of such federal acquiescence also were to be found in the history of other bilateral income tax treaties (*id.* at 736-39, 829 P.2d at 296-98) and in legislative histories of congressional bills (*id.* at 736, 829 P.2d at 296), the California Supreme Court applied *Wardair* to hold that (1) California's application of WWCR in this case has been permitted by Congress under its Commerce Clause powers, and (2) since Congress has acted to permit such application, no dormant Commerce Clause analysis was necessary. As the California Supreme Court properly applied *Wardair* in its *Barclay's* decision, once it is determined that Congress has acquiesced in the type of state taxation which is being challenged, there is absolutely no need for the courts to engage in any *dormant* Commerce Clause analysis. Therefore, in this case there is no necessity for this Court to review petitioner's claim that California's application of WWCR resulted in a violation of any of the elements of dormant Commerce Clause analysis.

II

PETITIONER'S STIPULATION LIMITING THE ISSUES TO BE LITIGATED IN THIS CASE BARS PETITIONER FROM PRESENTING FOR THIS COURT'S CONSIDERATION THE FOUR ELEMENTS OF DORMANT COMMERCE CLAUSE ANALYSIS SET FORTH IN *COMPLETE AUTO TRANSIT v. BRADY.*

Jurisdiction of this Court to review state court decisions is conferred by 28 U.S.C. § 1257. "It is well settled that this Court will not review a final judgment of a state court unless 'the record as a whole shows either expressly or by clear implication that the federal claim was adequately presented in the state system.' " *Bd. of Dirs. of Rotary Int'l v. Rotary Club*, 481 U.S. 537, 550 (1987). The issue of whether a federal question was sufficiently raised is itself ultimately a question to be decided by this Court. *Street v. New York*, 394 U.S. 576, 583 (1969). A litigant, however, must follow state procedures in raising the federal question. *In re Lamkin*, 355 U.S. 59 (1957).

The trial stipulation in this case (quoted above at pages 3-4) provides that the constitutional issues raised involve *only* the "one voice" and "multiple tax" elements of Foreign Commerce Clause analysis. Dormant Interstate Commerce Clause analysis as described in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), has four elements. These elements are the question of nexus, the question of fair apportionment, the question of discrimination, and the question of relationship between the services provided and the benefits received. With respect to dormant *Foreign* Commerce Clause analysis, this Court in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), indicated that in addition to those four elements,

two additional elements are also involved: enhanced risk of multiple taxation and impairment of the ability of the federal government to speak with one voice.[3] In the present case, the stipulation specifically limits the issues involved to the questions of "one voice" and "multiple taxation." This stipulation does not mention any of the four *Complete Auto* elements.[4]

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[3] The "one voice" issue has both nondormant and dormant Commerce Clause components: if Congress has acted so as to either permit or prohibit the type of state tax at issue, the one voice has spoken and all necessary Commerce Clause analysis is concluded; if the one voice has not spoken, then there is a dormant Commerce Clause context in which the courts must determine whether the challenged state tax implicates foreign policy issues which must be left to the Federal Government. See *Wardair*, 477 U.S. at 12-13, 7-9; *Container*, 463 U.S. at 194.

[4] Alcancorp's stipulation as to the issues also provides that "Alcan is not contesting the Board's determination that the Alcan Group Companies constitute a single unitary business. . . . " Appendix A hereto. Under *Container*, 463 U.S. at 169-71, 180-85, and as further clarified as to the discrimination element in *Trinova Corp. v. Michigan Dept. of Treasury*, ___ U.S. ___, 111 S.Ct. 818, 835 (1991), it is clear that Alcan's acceptance of the Board's determination that a unitary business exists necessarily leads to a conclusion in favor of California's use of worldwide combined reporting with respect to all four of the elements involved in a *Complete Auto* examination of the tax. It is no wonder that Alcancorp would like this Court to find that the reasoning in *Container* is "flawed" (Pet. 22) and would like to see a change in this Court's "present doctrine" (Pet. 18), even though such a suggestion is directly contrary to this Court's very recent confirmation that "the unitary business principle of taxation . . . does a better job of accounting for 'the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise' than, for example, geographical or transactional accounting." *Allied-Signal, Inc. v. Director, Div. of Taxation*, ___ U.S. ___, 112 S.Ct. 2251, 2261 (1992).

California follows the "theory of trial" doctrine with respect to its appellate practice. The "theory of trial" doctrine is based upon the rationale that a party should " . . . not [be] permitted to change his position and adopt a new and different theory on appeal. To permit him to do so would not only be unfair to the trial court, but manifestly unjust to the opposing litigant." *Ernst v. Searle*, 218 Cal. 233, 240-41, 22 P.2d 715, 718 (1933). A corollary to this rule is that ". . . stipulations as to legal issues . . . entered into in the trial court must be adhered to upon appeal." *Carmichael v. Reitz*, 17 Cal.App.3d 958, 969, 95 Cal.Rptr. 381, 386 (1971). The California Supreme Court has recently confirmed the California procedural rule that the California courts "will respect a stipulation limiting the issues in a case." *Title Ins. Co. v. State Bd. of Equalization*, 4 Cal.4th 715, 733, 842 P.2d 121, 132 (1992). Under the general "theory of trial" doctrine, and under the more specific procedural rule respecting stipulations which limit issues, in this case the California courts properly would not consider petitioner's assertion of dormant Commerce Clause grounds other than "one voice" and "multiple taxation."

Petitioner in its filings with the California courts did not cite to or discuss *Complete Auto* except belatedly in its filing of a supplemental brief with the Court of Appeal after this Court's decision in *Kraft General Foods, Inc. v. Iowa Dept. of Revenue*, ___ U.S. ___, 112 S.Ct. 2365 (1992), and in its petition and reply in the California Supreme Court. The Board recognizes that petitioner has throughout the proceeding peppered its arguments with allusions to nexus, fair apportionment and discrimination concerns

despite its stipulation as to the issues. The Board, however, has objected throughout the proceedings to petitioner's efforts to inject these dormant Commerce Clause considerations and Due Process Clause considerations into this case. Because the California Courts have found that all dormant Commerce Clause analysis is inappropriate under this Court's ruling in *Wardair Canada, Inc. v. Florida*, 477 U.S. 1 (1986), they have not found it necessary to address petitioner's efforts to broaden this case beyond the issues stated in the stipulation.[5]

State procedural rules which restrict the raising of federal questions to the early stages in a case have been recognized as valid exercises of state power. See *McKesson Corp. v. Florida Alcohol & Tobacco Div.*, 496 U.S. 18, 44-45 (1990); *Williams v. Georgia*, 349 U.S. 375, 382-383 (1955).[6] In this case, the California courts have not needed to give a direct ruling that Alcancorp's stipulation barred it from arguing the *Complete Auto Transit* dormant Commerce Clause elements. However, this Court has held with respect to silence on a federal question that "it

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[5] An exception should be noted in that the California appellate court specifically noted that Due Process Clause issues were not present in the case as a result of the stipulation. Pet. App. A-3, n. 2.

[6] In this Court's 1990 opinion in *Franchise Tax Bd. of Cal. v. Alcan Aluminium*, 493 U.S. 331, 340-41 (1990), this Court's denial of Tax Injunction Act relief to Alcancorp's parent corporation was based in part on an assurance that the subsidiaries had the capability of raising all potential Commerce Clause arguments in the California Courts. In making that assurance in oral argument, counsel for the Board was careful to point out that such capability would be subject to procedural defenses regularly provided by California law. Tr. of 11/1/89 Oral Arg. 6.

will be assumed that the omission was due to want of proper presentation in the state courts, unless the aggrieved party in this Court can affirmatively show the contrary." *Street v. New York*, 394 U.S. 576, 582 (1969). The same rationale is applicable in the instant case.

In discussing a supporting rationale for the jurisdictional bar when the federal issue was not ruled upon or considered by the state courts, this Court has recognized, "Questions not raised below are those on which the record is very likely to be inadequate, since it certainly was not compiled with those questions in mind." *Cardinale v. Louisiana*, 394 U.S. 437, 439 (1969). If ever there were a situation in which such a rationale had application, it must be in the circumstances of a case tried solely on stipulated facts with a limiting stipulation as to the issues involved. Respondent Board tried and defended this case under petitioner Alcancorp's stipulation as to the issues presented. To allow consideration of issues upon which respondent offered no evidence because the opposing litigant had stipulated them out of the case would be a grave injustice.

III

EVEN IF A DORMANT COMMERCE CLAUSE ANALYSIS WERE TO BE APPLIED, THERE WOULD BE NO VIOLATION OF THE MULTIPLE TAXATION OR "ONE VOICE" ELEMENTS OF THE *JAPAN LINE* TEST.

Alcan Aluminum Corporation seeks to raise a number of dormant Commerce Clause concerns in its petition. As set forth in argument I above, respondent

Board believes that the California courts correctly concluded that this Court's decision in *Wardair, supra,* renders unnecessary any consideration of any dormant Commerce Clause arguments. In addition, as argued in argument II above, petitioner's stipulation bars it from raising any dormant Commerce Clause issues beyond "one voice" and "multiple taxation" in this lawsuit. Therefore, respondent Board will address only the "one voice" and "multiple tax" elements of dormant Commerce Clause analysis in this portion of the argument. (By doing so, the Board does not intend to waive any right to argue that the other elements of a dormant Commerce Clause analysis would preclude Alcancorp's challenge to California's use of worldwide combined report accounting.)

As noted above at page 13 n. 4, Alcancorp's stipulation removing any issue that it was not engaged in a unitary business as determined by the Board (and any issue that Alcancorp was denied due process) necessarily leads under *Container* to a conclusion that California's use of WWCR was nondistortive. Under these circumstances, and if *Wardair* were somehow inapplicable, the only dormant Commerce Clause issues in this case would be whether this *"proper and fair method of taxation,"* because of its differences from other tax accounting methods, either (1) violates the "enhanced risk of multiple taxation" standard, or (2) " 'impair[s] federal uniformity in an area where federal uniformity is essential.' " *Container,* 463 U.S. at 185-86 (emphasis added).

A. Multiple Taxation

This Court in *Container* analyzed the multiple taxation element of *Japan Line*'s dormant Commerce Clause analysis in the context of the California tax here at issue. The Court stated:

> "In *Japan Line*, we said that '[e]ven a slight overlapping of tax – a problem that might be deemed *de minimis* in a domestic context – assumes importance when sensitive matters of foreign relations and national sovereignty are concerned.' [Citations omitted.] If we were to take that statement as an absolute prohibition on state-induced double taxation in the international context, then our analysis here would be at an end. But, in fact, such an absolute rule is no more appropriate here than it was in *Japan Line* itself. . . . Although double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny must take into account the context in which the double taxation takes place and the alternatives reasonably available to the taxing State." 463 U.S. at 189.

This Court's conclusion that, " . . . it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation" (*id.* at 193), is just as applicable in the present context. There is nothing in this Court's *Container* reasoning with respect to double taxation that is dependent on the domicile of the parent company. The law with respect to this issue is settled and is dispositive of the multiple tax issue in this case.

B. One Voice

In *Container* this Court set forth the standard to be applied in a dormant Foreign Commerce Clause "one voice" analysis. The Court stated:

> "In conducting this inquiry, however, we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States.' " 463 U.S. at 194.

In the truly dormant Commerce Clause portion of the "one voice" analysis (a pre-emption analysis falls outside of a dormant Commerce Clause analysis, see above at note 3) in *Container*, this Court determined that California's use of worldwide combined reporting with respect to a unitary business headed by a domestic corporation did not "impair federal uniformity in an area where federal uniformity is *essential*" by "implicat[ing] foreign policy issues which *must* be left to the Federal Government. . . . " *Id.* at 193, 194 (emphasis added). In making that determination, this Court applied the test of whether California's application of worldwide combined reporting in the *Container* context might "justifiably lead to significant foreign retaliation." *Id.* at 194. Under the *Container* facts, the Court found that three factors (lack of automatic asymmetry, entity upon whom the tax is imposed, and the amount of the tax burden) weighed strongly against there being any such *justifiable* retaliation. Except for the fact that the taxpayer corporation in the present case has a foreign parent corporation, those

same distinctions apply with equal force in this case. In addition, other factors establish that no retaliation could be justified.

A disagreement between a foreign country and this Court as to the fairness and propriety of worldwide combined reporting cannot form the basis for a "justifiable" retaliation, no matter how predictable retaliation might be given the foreign country's historical opposition to WWCR. This Court has held that the California tax at issue is a "proper and fair method of taxation" (463 U.S. at 184) which "reflect[s] a reasonable sense of how income is generated" (*id.* at 169-170) and which avoids the "basic theoretical weaknesses" of arm's length/separate accounting methods (*id.* at 181). In light of these conclusions of this Court, retaliation based on contrary views cannot be "justifiable."

An independent reason why retaliation is not justified in this case is the formulation of the U.S./Canada tax treaty now in force. Canada tried, and failed, to outlaw the states' use of worldwide combined reporting with respect to Canadian companies. Canada's acceptance of this fact is reflected in diplomatic notes exchanged between Canada and the United States. Exhibit XXVI-1 (App. C). Just as retaliation by the United Kingdom would be a direct violation of the US/UK treaty,[7]

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[7] The Executive Branch has explicitly recognized that the United Kingdom's threatened implementation of a retaliatory measure would clearly violate the US/UK treaty; Executive Branch testimony to Congress includes the following statement regarding the United Kingdom's retaliatory measure:

retaliation now by Canada would be inconsistent with the bargained-for U.S./Canada Treaty and thus clearly not justifiable.

Also, Canada has a federal system of government which is similar to that of the United States. This similarity, and Canada's concern for the sovereign rights of its provinces, led it to express a reservation (just as the United States did) to the OECD Model Treaty provisions which include subnational taxes within its reach. Exhibit XXIII, p. 50. Such separation and protection of the sovereign powers of its own subnational units of government would be inconsistent with a generalized retaliation by Canada against United States-related corporations because of California's method of tax accounting.

Finally, in 1986 California enacted legislation, operative in 1988, which allows both foreign and domestic based businesses, upon payment of a fee, to elect out of the use of WWCR and use a "water's-edge" method. In general, the "water's edge" method determines California taxable income of corporations which are part of multinational enterprises by applying formulary apportionment only to unitary activities within the "water's edge." Arm's length/separate accounting is used in analyzing transactions between corporations within the "water's edge" group and their foreign affiliates. Stip.

"We believe that its existence is inconsistent with the U.S.-U.K. bilateral income tax treaty to the extent its threatened use causes U.S. taxpayers to refrain from claiming benefits under the treaty. *Its actual implementation would be a clear violation of the treaty.*" Exh. XXX-9, p. 12 (emphasis added).

¶ 169, App. A hereto at App. 2, ¶ 169; Cal. Revenue and Taxation Code § 25110 (see Appendix B hereto). Since California has changed its law to provide an option to avoid WWCR, no foreign retaliation now for pre-1988 use of WWCR could be justifiable.

CONCLUSION

For the reasons given above, it is respectfully submitted that the petition for writ of certiorari should be denied. If this Court should decide to grant the petition, it is respectfully submitted that the issues to be argued should be limited solely to whether a dormant Commerce Clause analysis has been rendered unnecessary by congressional acquiescence in the states' use of WWCR, and, if any dormant Commerce Clause analysis is necessary, whether the "one voice" and "multiple taxation" elements of dormant Commerce Clause analysis would render California's actions impermissible.

Dated: June 2, 1993.

Respectfully submitted,

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APPENDIX A

EXCERPTS FROM STIPULATION OF FACTS

(Filed in the Superior Court of the State of California, County of Los Angeles, No. C-196604)

p. 2 (CT 0062):

ISSUES

For the purposes of this litigation, these parties hereby stipulate that the only legal issues before this Court are whether the Board's application of the unitary method of accounting under Section 25101 *et seq.* of the California Revenue and Taxation Code, and implementing regulations, as applied to the facts in this case violated the Foreign Commerce Clause of the United States Constitution in that such application impermissibly prevents the federal government from speaking with one voice or impermissibly gives rise to either the risk of or actual multiple taxation. For purposes of this litigation, Alcan is not contesting the Board's determination that the Alcan Group Companies constitute a single unitary business under the tests formulated by the California Courts and the United States Supreme Court, or contending that the tax assessed violated the Due Process Clauses of the United States Constitution or the California Constitution.

pp. 9-10 (CT 0069-0070):

23. Alcancorp has paid the additional assessments and has pursued administrative remedies with the Board regarding the Board assessments for the years 1965 through 1974, and has instituted suits for refund as authorized by California law. Alcancorp did not elect to

petition the Board for relief under the provisions of California Revenue and Taxation Code Section 25137. (See Exhibit XIX-1 for a copy of the original Los Angeles complaint and Exhibit XIX-2 for a copy of the original Sacramento complaint.)

p. 66 (CT 0126):

169. The California Legislature has passed and the Governor has signed various bills allowing taxpayers to elect to not use the worldwide combined report method. California Senate Bill 85 (Alquist) signed by Governor Deukmejian September 5, 1986, an act to add Chapter 1.9 (commencing with Section 15365), Chapter 6 (commencing with Section 15397), and Chapter 7 (commencing with Section 15398) to Part 6.7 of Division 3 of, and to add Article 12 (commencing with Section 16429.30) to Chapter 2 of Part 2 of Division 4 of, Title 2 of, the Government Code, to amend Sections 24274, 24344, 24348, 24667, and 24668 of, to amend and renumber Section 25110 of, to add Sections 24411 and 24670 to, and to add and repeal Article 1.5 (commencing with Section 25110) of Chapter 17 of Part II of Division 2 of, the Revenue and Taxation Code, relating to taxation is attached hereto as Exhibit XXXVII.

APPENDIX B

STATUTORY PROVISIONS

CALIFORNIA REVENUE AND TAXATION CODE

Section 25110 (water's edge election):

(a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b) which is subject to the tax imposed under this part, may elect to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election in accordance with the provisions of this part, as modified by this article. A taxpayer which makes a water's-edge election shall take into account the income and apportionment factors of the following affiliated entities only:

(1) Affiliated banks or corporations which are eligible to be included in a federal consolidated return as described in Sections 1501 to 1505, inclusive, of the Internal Revenue Code, other than corporations making an election under Section 936 of the Internal Revenue Code.

(2) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as described in Sections 921 to 927, inclusive, of the Infernal Revenue Code.

(3) Any corporation, regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United States is 20 percent or more.

(4) Banks and corporations which are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code, of which more than 50 percent of their stock is controlled directly or indirectly by the same interests, which are not included in paragraph (1).

(5) A bank or corporation which is not described in paragraphs (1) to (4), inclusive, or paragraph (6), but only to the extent of its income derived from or attributable to sources within the United States and its factors assignable to a location within the United States in accordance with paragraph (3) of subdivision (b). Income of such a bank or corporation derived from or attributable to sources within the United States as determined by federal income tax laws shall be limited to and determined from the books of account maintained by the bank or corporation with respect to its activities conducted within the United States.

(6) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(7) Any affiliated bank or corporation which is a "controlled foreign corporation", as defined in Section 957 of the Internal Revenue Code, if all or part of the income of that affiliate is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income"). The income and apportionment factors of any affiliate to be included under this paragraph shall be determined by multiplying the income of and apportionment factors of that affiliate without application of this paragraph by a fraction (not to exceed one), the numerator of which is the "Subpart F income", of that bank or corporation for that income year

and the denominator of which is the "earnings and profits" of that bank or corporation for that income year, as defined in Section 964 of the Internal Revenue Code.

(8) (A) The income and factors of the above-enumerated banks and corporations shall be taken into account only if the income and factors would have been taken into account under Section 25101 if this section had not been enacted. (B) The income and factors of a bank or corporation which is not described in paragraphs (1) to (4) inclusive, and (6) and which is an electing taxpayer under this subdivision shall be taken into account in determining its income only to the extent set forth in paragraph (5).

(b) For purpose of this article and Section 24411:

(1) An "Affiliated bank or corporation" means a bank or corporation which is related to a bank or corporation, required to file under this part, because of any of the following:

(A) It owns directly or indirectly more than 50 percent of the voting stock of the bank or a corporation required to file under this part.

(b) More than 50 percent of its voting stock is owned directly or indirectly by a bank or corporation required to file under this part.

(c) More than 50 percent of voting stock of both it and the bank or corporation required to file under this part is owned or controlled directly or indirectly by any bank or person (as defined in Section 7701(a)(1) of the Internal Revenue Code).

(2) A "qualified taxpayer" means a bank or corporation which does both of the following:

(A) Files with the state tax return on which the water's-edge election is made a consent to the taking of depositions at the time and place most reasonably convenient to all parties from key domestic corporation individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board as provided in Section 26423 or by the State Board of Equalization as provided in Title 18, California Code of Regulations, Section 5005, or by the courts of this state as provided in Chapter 2 (commencing with Section 1985) of Title 3 of Part 4 of, and Section 2025 of, the Code of Civil Procedure. The consent relates to issues of jurisdiction and service and does not waive any defenses a taxpayer may otherwise have. The consent shall remain in effect so long as the water's-edge election is in effect and shall be limited to providing that information necessary to review or to adjust income or deductions in a manner authorized under Sections 482, 861, Subpart F of Part III of Subchapter N, or similar provisions of the Internal Revenue Code, together with the regulations adopted pursuant to those provisions, and for the conduct of an investigation with respect to any unitary business in which the taxpayer may be involved.

(B) Agrees that for purposes of this article, dividends, received by any bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) from either of the following are functionally related dividends and shall be presumed to be business income:

(i) A bank or corporation of which more than 50 percent of the voting stock is owned, directly or indirectly, by

members of the unitary group and which is engaged in the same general line of business.

(ii) Any bank or corporation which is either a significant source of supply for the unitary business or a significant purchaser of the output of the unitary business, or which sells a significant part of its output or obtains a significant part of its raw materials or input from the unitary business. "Significant," as used in this subparagraph, means an amount of 15 percent or more of either input or output.

All other dividends shall be classified as business or nonbusiness income without regard to this subparagraph.

(3) The definitions and locations of property, payroll, and sales shall be determined under the laws and regulations which set forth the apportionment formulas used by the individual states to assign net income subject to taxes on or measured by net income in that state. If a state does not impose a tax on or measured by net income or does not have laws or regulations with respect to the assignment of property, payroll, and sales, the laws and regulations provided in Article 2 (commencing with Section 25120) shall apply.

Sales shall be considered to be made to a state only if the bank or corporation making the sale may otherwise be subject to a tax on or measured by net income under the Constitution or laws of the United States, and shall not include sales made to a bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) in determining the amount of income of the taxpayer derived from or attributable to sources within this state.

(4) "The United States" means the 50 states of the United States and the District of Columbia.

(c) All references in this part to income determined pursuant to Section 25101 shall also mean income determined pursuant to this section.

APPENDIX C

STIPULATION EXHIBIT XXVI-1

September 26, 1980

The Honorable
Alan J. MacEachen
Deputy Prime Minister and
Minister of Finance of Canada

Sir:

I have the honor to acknowledge receipt of your note of September 26, 1980, which reads as follows:

"I have the honour to refer to the Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed today, and to confirm certain understandings reached between the two Governments with respect to the Convention.

1. In French, the term "societe" also means "corporation" within the meaning of Canadian law.

2. The competent authorities of each of the Contracting States shall review the procedures and requirements for an organization of the other Contracting State to establish its status as a religious, scientific, literary, educational or charitable organization entitled to exemption under paragraph 1 of Article XXI (Exempt Organizations), or as an eligible recipient of the charitable contributions or gifts referred to in paragraphs 5 and 6 of Article XXI, with a view to avoiding duplicate application by such organizations to the administering agencies of both Contracting States.

If a Contacting State determines that the other Contracting State maintains procedures to determine such

status and rules for qualification that are compatible with such procedures and rules of the first-mentioned Contracting State, it is contemplated that such first-mentioned Contracting State shall accept the certification of the administering agency of the other Contracting State as to such status for the purpose of making the necessary determinations under paragraphs 1, 5 and 6 of Article XXI.

It is further agreed that the term "family," as used in paragraphs 5 and 6 of Article XXI, means an individual's brothers and sisters (whether by whole or half-blood, or by adoption), spouse, ancestors, lineal descendants and adopted descendants.

3. It is the position of Canada that the so-called "unitary apportionment" method used by certain states of the United States to allocate income to United States offices or subsidiaries of Canadian companies results in inequitable taxation and imposes excessive administrative burdens on Canadian companies doing business in those states. Under that method the profit of a Canadian company on its United States business is not determined on the basis of arm's-length relations but is derived from a formula taking account of the income of the Canadian company and its world-wide subsidiaries as well as the assets, payroll and sales of all such companies. For a Canadian multinational company with many subsidiaries in different countries to have to submit its books and records for all of these companies to a state of the United States imposes a costly burden. It is understood that the Senate of the United States has not consented to any limitation on the taxing jurisdiction of the states by a treaty and that a provision which would have restricted

the use of unitary apportionment in the case of United Kingdom corporations was recently rejected by the Senate. Canada continues to be concerned about this issue as it affects Canadian multinationals. If an acceptable position on this subject can be devised, the United States agrees to reopen discussions with Canada on this subject.

4. I have the honour to propose to you that the present Note and your reply thereto shall constitute an agreement between our two Governments on these matters."

I confirm these understandings on behalf of the Government of the United States of America. These understandings constitute an agreement between our two Governments on this matter, which will enter into force on the date of entry into force of the Convention between the Government of the United States of America and the Government of Canada with Respect to Taxes on Income and on Capital which was signed today.

Accept, Sir, the renewed assurances of my highest consideration.

(Signed by: G. William Miller
Secretary of the Treasury)